

**REPORT OF THE AUDIT OF THE
FORMER LEE COUNTY
SHERIFF**

**For The Year Ended
December 31, 2006**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
www.auditor.ky.gov**

**105 SEA HERO ROAD, SUITE 2
FRANKFORT, KY 40601-5404
TELEPHONE (502) 573-0050
FACSIMILE (502) 573-0067**

EXECUTIVE SUMMARY

AUDIT EXAMINATION OF THE LEE COUNTY SHERIFF

**For The Year Ended
December 31, 2006**

The Auditor of Public Accounts has completed the former Lee County Sheriff's audit for the year ended December 31, 2006. Based upon the audit work performed, the financial statement presents fairly, in all material respects, the revenues, expenditures, and excess fees in conformity with the regulatory basis of accounting.

Financial Condition:

Excess fees increased by \$57 from the prior year, resulting in excess fees of \$126 as of December 31, 2006. Revenues increased by \$4,109 from the prior year and expenditures increased by \$4,052.

Report Comments:

- All Court Security Deputies Should Be Compensated As Employees
- The Sheriff's Office Lacked Adequate Segregation of Duties

Deposits:

The former Sheriff's deposits as of November 30, 2006 were exposed to custodial credit risk as follows:

- Uncollateralized and Uninsured \$539,838

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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Steve Mays, Lee County Judge/Executive
The Honorable Harvey Pelfrey, Former Lee County Sheriff
The Honorable Donnie Hogan, Lee County Sheriff
Members of the Lee County Fiscal Court

Independent Auditor's Report

We have audited the accompanying statement of revenues, expenditures, and excess fees - regulatory basis of the former Sheriff of Lee County, Kentucky, for the year ended December 31, 2006. This financial statement is the responsibility of the former Sheriff. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the Audit Guide for County Fee Officials issued by the Auditor of Public Accounts, Commonwealth of Kentucky. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Sheriff's office prepares the financial statement on a regulatory basis of accounting that demonstrates compliance with the laws of Kentucky, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to above presents fairly, in all material respects, the revenues, expenditures, and excess fees of the Sheriff for the year ended December 31, 2006, in conformity with the regulatory basis of accounting described in Note 1.

In accordance with Government Auditing Standards, we have also issued our report dated January 29, 2008 on our consideration of the former Sheriff's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.



The Honorable Steve Mays, Lee County Judge/Executive
The Honorable Harvey Pelfrey, Former Lee County Sheriff
The Honorable Donnie Hogan, Lee County Sheriff
Members of the Lee County Fiscal Court

Based on the results of our audit, we have presented the accompanying comments and recommendations, included herein, which discusses the following report comments:

- All Court Security Deputies Should Be Compensated As Employees
- The Sheriff's Office Lacked Adequate Segregation of Duties

This report is intended solely for the information and use of the former Sheriff and Fiscal Court of Lee County, Kentucky, and the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these interested parties.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen", with a stylized, flowing script.

Crit Luallen
Auditor of Public Accounts

January 29, 2008

LEE COUNTY
HARVEY PELFREY, FORMER SHERIFF
STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS

For The Year Ended December 31, 2006

Revenues

Federal Grant:		
Justice Assistance Grant	\$	3,609
State Grant:		
Justice and Public Safety Grant		1,114
State - Kentucky Law Enforcement Foundation Program Fund		4,643
State Fees For Services:		
Finance and Administration Cabinet	\$	1,193
Cabinet For Health And Family Services	190	1,383
Circuit Court Clerk:		
Sheriff Security Service	13,151	
Fines and Fees Collected	445	
Court Ordered Payments	194	13,790
Fiscal Court		100
County Clerk - Delinquent Taxes		1,931
Commission On Taxes Collected		69,474
Fees Collected For Services:		
Jail Diversion	3,360	
Auto Inspections	935	
Accident and Police Reports	241	
Serving Papers	8,210	
Carrying Concealed Deadly Weapon Permits	3,350	16,096
Other:		
10% Add-On Fee	10,729	
Sheriff's Tax Collection Fees	475	
Excise Tax	1,512	
Miscellaneous	896	13,612
Interest Earned		378
Borrowed Money:		
State Advancement		26,000
Total Revenues		152,130

The accompanying notes are an integral part of this financial statement.

LEE COUNTY
HARVEY PELFREY, FORMER SHERIFF
STATEMENT OF REVENUES, EXPENDITURES, AND EXCESS FEES - REGULATORY BASIS
For The Year Ended December 31, 2006
(Continued)

Operating Expenditures and Capital Outlay:

Personnel Services-		
Deputies' Salaries	\$	9,300
Contracted Services-		
Advertising		538
Vehicle Maintenance and Repairs		3,834
Contract Labor		103
Materials and Supplies-		
Office Materials and Supplies		622
Uniforms		1,514
Auto Expense-		
Gasoline		23,498
Other Charges-		
Reimbursement to Fiscal Court		10,902
Reimbursement to Criminal Justice		1,681
Travel Expenses		87
Postage		228
Computer Maintenance Fee		975
Bond		558
CCDW		2,400
Miscellaneous		123
Mobile Phone		1,951
Debt Service:		
State Advancement		<u>26,000</u>
Total Expenditures		<u>84,314</u>
Net Revenues	\$	67,816
Less: Statutory Maximum		<u>64,388</u>
Excess Fees		3,428
Less: Training Incentive Benefit		<u>3,302</u>
Balance Due Fiscal Court at Completion of Audit	\$	<u><u>126</u></u>

The accompanying notes are an integral part of this financial statement.

LEE COUNTY
NOTES TO FINANCIAL STATEMENT

December 31, 2006

Note 1. Summary of Significant Accounting Policies

A. Fund Accounting

A fee official uses a fund to report on the results of operations. A fund is a separate accounting entity with a self-balancing set of accounts. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities.

A fee official uses a fund for fees to account for activities for which the government desires periodic determination of the excess of revenues over expenditures to facilitate management control, accountability, and compliance with laws.

B. Basis of Accounting

KRS 64.820 directs the fiscal court to collect any amount, including excess fees, due from the Sheriff as determined by the audit. KRS 134.310 requires the Sheriff to settle excess fees with the fiscal court at the time he files his final settlement with the fiscal court.

The financial statement has been prepared on a regulatory basis of accounting, which demonstrates compliance with the laws of Kentucky and is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. Under this regulatory basis of accounting revenues and expenditures are generally recognized when cash is received or disbursed with the exception of accrual of the following items (not all-inclusive) at December 31 that may be included in the excess fees calculation:

- Interest receivable
- Collection on accounts due from others for 2006 services
- Reimbursements for 2006 activities
- Tax commissions due from December tax collections
- Payments due other governmental entities for payroll
- Payments due vendors for goods or services provided in 2006

The measurement focus of a fee official is upon excess fees. Remittance of excess fees is due to the County Treasurer in the subsequent year.

C. Cash and Investments

At the direction of the fiscal court, KRS 66.480 authorizes the Sheriff's office to invest in the following, including but not limited to, obligations of the United States and of its agencies and instrumentalities, obligations and contracts for future delivery or purchase of obligations backed by the full faith and credit of the United States, obligations of any corporation of the United States government, bonds or certificates of indebtedness of this state, and certificates of deposit issued by or other interest-bearing accounts of any bank or savings and loan institution which are insured by the Federal Deposit Insurance Corporation (FDIC) or which are collateralized, to the extent uninsured, by any obligation permitted by KRS 41.240(4).

LEE COUNTY
 NOTES TO FINANCIAL STATEMENT
 December 31, 2006
 (Continued)

Note 2. Employee Retirement System

The county officials and employees have elected to participate in the County Employees Retirement System (CERS), pursuant to KRS 78.530 administered by the Board of Trustees of the Kentucky Retirement Systems. This is a cost-sharing, multiple-employer, defined benefit pension plan that covers all eligible full-time employees and provides for retirement, disability, and death benefits to plan members.

Benefit contributions and provisions are established by statute. Nonhazardous covered employees are required to contribute 5.0 percent of their salary to the plan. The county's contribution rate for nonhazardous employees was 10.98 percent for the first six months and 13.19 percent for the last six months of the year. Hazardous covered employees are required to contribute 8 percent of their salary to the plan. The county's contribution rate for hazardous employees was 25.01 percent for the first six months and 28.21 percent for the last six months of the year.

Benefits fully vest on reaching five years of service for nonhazardous employees. Aspects of benefits for nonhazardous employees include retirement after 27 years of service or age 65. Aspects of benefits for hazardous employees include retirement after 20 years of service or age 55.

Historical trend information pertaining to CERS' progress in accumulating sufficient assets to pay benefits when due is presented in the Kentucky Retirement Systems' annual financial report which is a matter of public record. This report may be obtained by writing the Kentucky Retirement Systems, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-4646.

Note 3. Deposits

The former Sheriff maintained deposits of public funds with depository institutions insured by the Federal Deposit Insurance Corporation (FDIC) as required by KRS 66.480(1)(d). According to KRS 41.240(4), the depository institution should pledge or provide sufficient collateral which, together with FDIC insurance, equals or exceeds the amount of public funds on deposit at all times. In order to be valid against the FDIC in the event of failure or insolvency of the depository institution, this pledge or provision of collateral should be evidenced by an agreement between the Sheriff and the depository institution, signed by both parties, that is (a) in writing, (b) approved by the board of directors of the depository institution or its loan committee, which approval must be reflected in the minutes of the board or committee, and (c) an official record of the depository institution.

Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a depository institution failure, the Sheriff's deposits may not be returned. The former Sheriff did not have a deposit policy for custodial credit risk but rather followed the requirements of KRS 41.240(4). On November 30, 2006, \$539,838 of the former Sheriff's bank balance was exposed to custodial credit risk as follows:

- Uninsured and Unsecured \$539,838

LEE COUNTY
NOTES TO FINANCIAL STATEMENT
December 31, 2006
(Continued)

Note 4. Justice Assistance Grant

The former Sheriff received a Justice and Public Safety grant in the amount of \$4,723. These funds were used to upgrade the Sheriff's office equipment.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF THE FINANCIAL
STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

The Honorable Steve Mays, Lee County Judge/Executive
The Honorable Harvey Pelfrey, Former Lee County Sheriff
The Honorable Donnie Hogan, Lee County Sheriff
Members of the Lee County Fiscal Court

Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards

We have audited the statement of revenues, expenditures, and excess fees - regulatory basis of the former Lee County Sheriff for the year ended December 31, 2006, and have issued our report thereon dated January 29, 2008. The former Sheriff's financial statement is prepared in accordance with a basis of accounting other than generally accepted accounting principles. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the former Lee County Sheriff's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the former Lee County Sheriff's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the former Lee County Sheriff's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the regulatory basis of accounting such that there is more than a remote likelihood that a misstatement of the entity's financial statement that is more than inconsequential will not be prevented or detected by the entity's internal control over financial reporting. We consider the deficiency described in the accompanying comments and recommendations to be a significant deficiency in internal control over financial reporting.

- The Former Sheriff's Office Lacked Adequate Segregation Of Duties



Report On Internal Control Over Financial Reporting And
On Compliance And Other Matters Based On An Audit Of The Financial
Statement Performed In Accordance With Government Auditing Standards
(Continued)

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statement will not be prevented or detected by the entity's internal control. Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the former Lee County Sheriff's financial statement for the year ended December 31, 2006, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under Government Auditing Standards and which is described in the accompanying comments and recommendations.

- All Court Security Deputies Should Be Compensated As Employees

This report is intended solely for the information and use of management, the Lee County Fiscal Court, and the Kentucky Governor's Office for Local Development and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen
Auditor of Public Accounts

January 29, 2008

COMMENTS AND RECOMMENDATIONS

LEE COUNTY
HARVEY PELFREY, FORMER SHERIFF
COMMENTS AND RECOMMENDATIONS

For The Year Ended December 31, 2006

STATE LAWS AND REGULATIONS:

All Court Security Deputies Should Be Compensated As Employees

The former Sheriff had two (2) part-time deputies performing court security one being paid as a contractor and one as an employee. Court security is a statutory duty of a Sheriff's office, and all deputies performing this duty should be compensated as employees. The result of treating one of these deputies as a contractor is an underpayment of tax liabilities. The former Sheriff should have withheld federal and state income taxes and paid social security and Medicare taxes on this employee. We recommend the former Sheriff contact the appropriate agencies to determine the appropriate corrective action. We will be referring this matter to the Internal Revenue Service, Social Security Administration, and Kentucky Department of Revenue for review.

Former Sheriff's Response: None

INTERNAL CONTROL - MATERIAL WEAKNESS:

The Former Sheriff's Office Lacked Adequate Segregation Of Duties

The former Sheriff's office lacked a proper segregation of duties because the bookkeeper received all funds, prepared the daily checkout sheets, and also prepared the bank deposits. In addition, the bookkeeper recorded the receipts in the receipts ledger, prepared and signed the checks, posted to the disbursements ledgers, prepared bank reconciliations and quarterly financial statements. This design in the internal control structure does not reduce the level of risk that errors and fraud may occur and not be detected within a timely period by employees in the normal course of performing their assigned duties. The former Sheriff could have segregated these duties or implemented compensating controls by periodically recounting and making the deposit, performing surprise cash counts, and reconciling monthly reports to source documents and to the receipts and disbursements ledger.

Former Sheriff's Response: None

